

Message Text

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ACTION EB-11

INFO OCT-01 EUR-25 EA-11 ISO-00 SP-03 AID-20 NSC-07 RSC-01

CIEP-03 TRSE-00 SS-20 STR-08 OMB-01 CEA-02 CIAE-00

COME-00 FRB-03 INR-11 NSAE-00 XMB-07 OPIC-12 LAB-06

SIL-01 PA-04 PRS-01 USIA-15 IO-14 L-03 H-03 AGR-20

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FM AMEMBASSY CANBERRA

TO SECSTATE WASHDC 4147

INFO AMCONSUL BRISBANE

AMEMBASSY LONDON

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E.O. 11652: N/A

TAGS: EFIN, AS

SUBJ: DEVALUATION OF AUSTRALIAN DOLLAR

REF: (A) CANBERRA 6260; (B) CANBERRA 6158; (C) CANBERRA 6146
(NOTAL); (D) CANBERRA 5889

1. SUMMARY: THIS CONTAINS ADDED DETAILS AND INITIAL
ASSESSMENT OF 12 PCT. AUSTRALIAN DOLLAR DEVALUATION
ANNOUNCED EARLY THIS MORNING. WHILE OFFICOAL CIRCLES
TIGHT-LIPPED, STANDING ON TERMS OF BRIEF OFFICIAL
ANNOUNCEMENT, MAJORITY OF PRIVATE COMMENT VIEWS MOVE
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AS HASTY POLITICAL STEP TO PROMOTE GOVERNMENT-LABOR

AGREEMENT ON WAGE RESTRAINT (PARA 6 REFTEL B). IN THIS VIEW DEVALUATION, WHICH WOULD EVENTUALLY HAVE BECOME ESSENTIAL FOR BALANCE OF PAYMENTS REASONS, ADVANCED SEVERAL MONTHS IN TIME TO COINCIDE WITH CURRENT ACTU DELIBERATIONS ON WHETHER TO COOPERATE WITH GOVERNMENT IN WAGE RESTRAINT. THERE IS GENERAL AGREEMENT MOVE WILL INCREASE INFLATIONARY FORCES AND CONSIDERABLE DOUBT THAT THIS WILL BE EQUALLED OR OFFSET BY AMOUNT OF WAGE RESTRAINT IT EVENTUALLY ELICITS. EFFECT IN DEPRESSING IMPORTS LIKELY TO BE DELAYED SEVERAL MONTHS. ADVERSE EFFECT ON U.S. EXPORTS LIVELY TO BE CONCENTRATED ON VARIETY OF CONSUMERS GOODS. EFFECT ON INVESTMENT INFLOW POSSIBLY MORE RAPID AS INVESTOR UNCERTAINTY OVER DEVALUATION PARTIALLY RELIEVED. WHILE DEVALUATION WILL REDUCE PRESSURES FOR GENERAL TARIFF REVISION, IT SEEMS UNLIKELY TO MEET DEMANDS OF SELECTED DISTRESSED INDUSTRIES, AND INDIVIDUAL COMMODITY QUOTA OR RESTRAINT MEASURES STILL APPEAR PROBABLE. END SUMMARY.

2. OFFICIAL COMMENT ON DEVALUATION MOVE VERY GUARDED, REMAINING WITHIN TERMS OF BRIEF OFFICIAL ANNOUNCEMENT WHICH STRESSED CHANGED AUST. BALANCE OF PAYMENTS POSITION, AND SLOWDOWN IN DOMESTIC ECONOMY AND CITED EFFECTIVE APPRECIATION OF AUSTRALIAN DOLLAR SINCE SEPTEMBER 1973 AS RESULT OF STRENGTHENING U.S. DOLLAR. STATEMENT PREDICTS DEVALUATION WILL IMPROVE BUSINESS CLIMATE AND THEREBY HELP RESTORE LEVEL OF BUSINESS ACTIVITY AND EMPLOYMENT. STATEMENT CONTINUES THAT UNCHECKED UNEMPLOYMENT COULD DESTROY EFFORTS GOVERNMENT MAKING IN COOPERATION WITH UNIONS, EMPLOYERS AND STATES TO REDUCE INFLATION. NO USEFUL OFFICIAL COMMENT AVAILABLE ON CONFLICT BETWEEN ANTI-INFLATION EFFORTS AND INFLATIONARY EFFECTS OF DEVALUATION.

3. AS FIRST REACTION MOST PRIVATE OBSERVERS SURMISE GOVERNMENT DECIDED TO ADVANCE BY SEVERAL MONTHS A DEVALUATION, WHICH LOOKED INCREASINGLY UNAVOIDABLE, LIMITED OFFICIAL USE

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IN ORDER TO COINCIDE WITH SEPTEMBER 23-24 ACTU MEETINGS (PARA 6 REFTEL B). THESE MEETINGS ADJOURNED SEPTEMBER 24 AFTER DRAFTING RESOLUTION FOR CONSIDERATION TODAY BY ACTU EXECUTIVE, RECOMMENDING LABOR AGREE TO EXERCISE WAGE DEMAND RESTRAINT PROVIDED GOVERNMENT MET AMBITIOUS LIST OF LABOR CONDITIONS. THESE CONDITIONS ALL POINTED TOWARD MAINTENANCE OF PROGRESS IN REAL WAGES WHILE RESTORING FULL EMPLOYMENT NOW

THREATENED ESPECIALLY BY IMPORT COMPETITION. CONSENSUS OF OBSERVERS IS THAT UNEXPECTEDLY EARLY TIMING OF DEVALUATION IS PURELY POLITICAL MOVE EVEN THOUGH EVENTUAL DEVALUATION BY END OF 1974 OR EARLY 1975 HAD INCREASINGLY SEEMED LIKELY.

4. THERE IS CIRCUMSTANTIAL BUT QUITE INCONCLUSIVE EVIDENCE THAT DEVALUATION DECISION WAS HASTY. HIGHLY CRITICAL WHITLAM SPEECH SEPTEMBER 24 BEFORE INDUSTRY GROUP IN CANBERRA ALLEGED MANAGEMENT AND LABOR GROUPS COLLABORATING IN DELIBERATE PROPAGATION OF KNOWINGLY UNFOUNDED CLAIMS OVERSTATING EMPLOYMENT EFFECTS OF IMPORTS. SPEECH DENOUNCED THEIR DISHONESTY AND FRAUD AS WELL AS GULLIBILITY IN POLITICAL, INCLUDING ALP, CIRCLES. WHITLAM STRONGLY REAFFIRMED HIS ATTACHMENT TO TARIFF REFORM AND INDUSTRIAL RESTRUCTURING. THIS SPEECH EVOKED ANGRY REACTION IN CURRENT ACTU MEETING CREATED SERIOUS ALP LEADERSHIP RIFT AND LET TO BITTER EXCHANGES SEPTEMBER 24 IN PARLIAMENT REQUIRING CONCILIATORY MOVE. OTHER POINTS WHICH SUPPORT THIS SPECULATION ARE UNUSUAL MID-WEEK TIMING OF ANNOUNCEMENT, PRECEDING WHITLAM'S PROSPECTIVE TWO-WEEK ABSENCE FROM AUSTRALIA COMMENCING SEPTEMBER 27.

5. EMBASSY HAS CONFIRMED WITH TREASURY MORE DETAILS OF NEW DAILY RATE SETTING PROCEDURE. HEREAFTER RESERVE BANK WILL PROVIDE TRADING BANKS WITH DAILY RATE FOR AUSTRALIAN DOLLAR, EXPRESSED IN TERMS OF U.S. DOLLAR. THIS RATE WILL REPRESENT THE RATE FOR THE PREVIOUS DAY ADJUSTED UPWARD OR DOWNWARD BY A PERCENTAGE EQUAL TO THE WEIGHTED AVERAGE PERCENTAGE MOVEMENT OF OTHER SIGNIFICANT TRADING CURRENCIES RELATIVE TO THE U.S. DOLLAR. THIS IS THEREFORE NOT IN ANY FULL SENSE A LIMITED OFFICIAL USE

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"FLOAT" BUT IS RATHER AN OVERNIGHT REDUCTION OF 12 PCT. AGAINST THE U.S. DOLLAR, AND A PROCEDURE TO ALLOW THE AUSTRALIAN DOLLAR THEREAFTER TO FLUCTUATE DAILY ABOVE AND BELOW THE PRESELECTED U.S. \$1.3090 VALUE IN ACCORDANCE WITH THE WEIGHTED AVERAGE OF THE MOVEMENTS OF OTHER SIGNIFICANT CURRENCIES AGAINST THE U.S. DOLLAR.

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SIL-01 PA-04 PRS-01 USIA-15 IO-14 L-03 H-03 AGR-20

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6. NO DETAILS AVAILABLE RESPECTING COMPOSITION OF THE "BASKET" BUT THERE IS SOME REASON TO EXPECT IT WILL BE LIMITED TO THE NUMBER OF CURRENCIES REQUIRED TO ACCOUNT FOR 70 OR 80 PCT. OF AUSTRALIA'S TRADE. IT IS UNOFFICIALLY EXPECTED THAT THE WEIGHTING OF THE CURRENCIES IN THE BASKET WILL BE ADJUSTED ONLY AT SEMI-ANNUAL OR ANNUAL INTERVALS IN THE GEOGRAPHIC COMPOSITION OF AUSTRALIAN TRADE.

7. FIRST QUICK CANVASS OF FINANCIAL AND TRADE CONTACTS BY CONGENS MELBOURNE AND SYDNEY SHOWS
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TRADE VIEW THAT EFFECT ON U.S. EXPORTS WILL BE MODERATE. GOODS AFFECTED MAY INCLUDE A LIMITED

NUMBER OF TEXTILE PRODUCTS, CARPETING, AND CONSUMER GOODS SUCH AS WHITE GOODS. ESTABLISHED EXPORTS SUCH AS MACHINERY, BOTH ELECTRIC AND NON-ELECTRIC, TRANSPORT EQUIPMENT, CHEMICALS -- IN GENERAL, CAPITAL GOODS AND HIGH TECHNOLOGY PRODUCTS -- SHOULD NOT BE AFFECTED. SUBJECT TO FURTHER SHIFTS IN WORLD EXCHANGE RATES, EXPORTS OF COMPETING EXPORTERS SUCH AS JAPANESE AND BRITISH AFFECTED TO SAME EXTENT AS U.S. AND SHOULD ENJOY NO ADVANTAGE. IT IS ALSO CONCEIVABLE THAT AUSTRALIAN IMPORTERS HAVE A SUBSTANTIAL CUSHION TO ABSORB INCREASED LANDED COSTS. NTM EXPORTERS LIKELY TO FIND MARKET ENTRY MORE DIFFICULT. SINCE THE GROWTH OF DEMAND FOR U.S. EXPORTS WAS ALMOST CERTAINLY DESTINED TO EASE FROM PRESENT EXTRAORDINARY LEVEL, IT MAY PROVE DIFFICULT TO DISTINGUISH NEW EFFECTS OF PRESENT DEVALUATION. FAVORABLE INCOME EFFECT IN RURAL SECTOR (INCREASED PRICES OF AUSTRALIAN EXPORTS, FOR EXAMPLE, WHEAT AND SUGAR) MAY BOLSTER DEMAND FOR U.S. AGRICULTURAL MACHINERY. SIMILARLY TO EXTENT CAPITAL INFLOWS ARE STIMULATED, DEMAND FOR U.S. INVESTMENT GOODS MAY STRENGTHEN.

8. WHILE THE GOA HAS MADE NO FURTHER ADJUSTMENT IN THE CURRENT 5 PCT. VARIABLE DEPOSIT RATE FOR INCOMING LONG-TERM CAPITAL, IT EXPECTS DEVALUATION TO HAVE MORE RAPID EFFECT ON LEVEL OF CAPITAL MOVEMENT THAN ON IMPORTS. RECENT SUCCESSIVE REDUCTIONS IN VRD FROM 33 1/3 TO 25 PCT. AND FROM 25 TO 5 PCT. PRODUCED SLUGGISH RESPONSE BY FOREIGN CAPITAL. SINCE THE 5 PCT. RATE IS NOW A NOMINAL IMPEDIMENT, THE UNCERTAINTY OVER DEVALUATION WAS PROBABLY AN IMPORTANT REMAINING OBSTACLE.

9. EMBASSY SUMMARY COMMENT: ASIDE FROM THE SPECULATIVE QUESTION OF ITS TACTICAL BACKGROUND, THIS SUDDEN MOVE POSES THREE MAIN QUESTIONS OF FUTURE INTEREST:

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- (1) ITS NET EFFECT ON INFLATION,
- (2) ITS EFFECT ON U.S. TRADE AND INVESTMENT,
- (3) THE PROSPECT FOR AUSTRALIAN IMPORT POLICY IN THE WAKE OF DEVALUATION

INFLATIONARY EFFECT - THE IMMEDIATE INFLATIONARY EFFECT IS OBVIOUS. AS A MINIMUM IT WILL RAISE THE PRICE OF MANY IMPORTS, AND THE DOMESTIC INCOME TO THE EXPORT SECTOR. AS AND IF IT EVENTUALLY DEPRESSES

AUSTRALIA'S IMPORT BILL AND REDUCES THE CURRENT ACCOUNT DEFICIT, IT WILL CORRESPONDINGLY EASE THE LATTER'S DEFLATIONARY EFFECT. THE NEW SITUATION WILL PUT NEW PRESSURE ON DOMESTIC MONETARY POLICY TO CONTAIN INFLATION. ON THE OTHER HAND, IT IS VERY EARLY TO JUDGE WHETHER THE INFLATIONARY PRICE OF THE DEVALUATION WILL BE COMPENSATED BY SERIOUS WAGE RESTRAINT ACTIONS ON THE COST INFLATION SIDE BY ORGANIZED LABOR. THE DEVALUATION IS RESPONSIVE TO SOME DEGREE TO ONE, BUT ONLY ONE, IMPORTANT LABOR DEMAND AND MAY OR MAY NOT IN CONJUNCTION WITH OTHER GOVERNMENT COMMITMENTS OR MEASURES INDUCE A WAGE RESTRAINT COMMITMENT BY THE ACTU EXECUTIVE. THE FURTHER QUESTION REMAINS WHETHER FAVORABLE ACTION BY THE EXECUTIVE WOULD EVENTUALLY BE TRANSLATED INTO EFFECTIVE WAGE RESTRAINT BY INDIVIDUAL UNIONS, WHICH HAVE THE FINAL VOICE IN THEIR OWN TACTICS. ONLY THE MOST OPTIMISTIC OBSERVERS EXPECT THAT AMOUNT OF EFFECTIVE RESTRAINT TO COME OUT OF THE CURRENT ACTU EXERCISE.

EFFECT ON U.S. TRADE AND INVESTMENT - IN THE LONG RUN THE DEVALUATION WILL MODERATELY RESTRAIN U.S. EXPORTS. BECAUSE OF THE VARIABLE RATE TECHNIQUE THE LONG-RUN EFFECT MAY DIFFER AMONG EXPORTING COUNTRIES. THE MOST IMPORTANT LOSS OF ADVANTAGE IN U.S. TRADE MAY BE IN THE CONSUMER GOODS SECTOR WHICH HAS GROWN RELATIVELY RAPIDLY DURING THE PAST 18 MONTHS. THE EFFECT ON U.S. INVESTMENT IN AUSTRALIA SHOULD BE FAVORABLE, SINCE THE LARGE AMOUNT OF U.S. INVESTMENT IN MINING WILL BENEFIT FROM BETTER AUSTRALIAN EXPORT PRICES, WHILE LIMITED OFFICIAL USE

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INVESTMENT IN DOMESTIC MANUFACTURING WILL RECEIVE INCREASED PROTECTION.

FUTURE IMPORT POLICY - THE DEVALUATION WILL HAVE SOMEWHAT THE SAME EFFECT ON IMPORTS AS A PARTIAL WITHDRAWAL OF THE JULY 1973 25 PCT. TARIFF CUT. BUT IT SEEMS UNLIKELY TO MEET THE SPECIAL PROBLEMS OF THE SPECIALLY IMPORT-SENSITIVE AREAS OF AUSTRALIAN INDUSTRY. THE AUTOMOTIVE INDUSTRY MAY FIND SOME COMFORT IN ITS COMPETITION WITH IMPORTS FROM JAPAN. BUT IN THE CASE OF TEXTILES, APPAREL, FOOTWEAR, GLASS AND OTHER PROBLEM AREAS NOW SURFACING, PRESSURE FROM SPECIAL COMMODITY IMPORT RESTRICTIONS WILL CONTINUE AND IT SEEMS PROBABLE THAT SUCH MEASURES MAY BE ADOPTED ON A CASE-BY-CASE BASIS DESPITE THE DEVALUATION.

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